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Legend

Grantor	=
Trust	=
Spouse	=
Date 1	=
Company 1	=
Company 2	=
Trustee 1	=
Trustee 2	=
Exchange 1	=
Exchange 2	=

Dear :

This is in response to your January 23, 2008 letter and other correspondence requesting income, gift, and estate tax rulings concerning the proposed exercise of a power of substitution.

The facts submitted are as follows:

On Date 1, Grantor executed Trust. Trustee 1 and Trustee 2 were appointed as initial trustees of Trust. Section 1.1A of Trust provides that if Grantor is living, the trustee may distribute to Grantor's wife (Spouse) as much of the Trust property as the trustee determines for any reason not prohibited by Trust. If Grantor is not living, the trustee shall distribute to Spouse as much of the Trust property as Trustee determines for her health, maintenance, and support and may distribute as much additional Trust

property as trustee determines for any reason not prohibited by Trust. Any income not distributed within 65 days of the end of a calendar year shall be added to principal.

Section 1.1B of Trust provides that in addition, the trustee shall distribute Trust property to any one or more of Grantor's issue, in such amount or proportions and upon such terms, conditions, or trust as Spouse appoints by a writing containing an express reference to this lifetime limited power of appointment; provided, however, in no event may the trustee make a distribution that is in lieu of any obligation of Spouse to support any person.

Section 1.2 of Trust provides that upon the death of Spouse, the trustee shall distribute the Trust property to any one or more persons or entities, excluding Spouse's creditors, her estate and the creditors of her estate, in such amounts or proportions and upon such terms, conditions or trusts as Spouse appoints by will containing an express reference to this power of appointment. The trustee shall distribute any unappointed Trust property to Grantor's issue, per stirpes. If none of Grantor's issue is then living, the trustee shall distribute the Trust property equally among Grantor's siblings who are then living or to the issue, per stirpes, of any sibling who is then deceased.

Section 2.1 of Trust provides, in relevant part, that during the period hereinafter described Spouse may withdraw an amount equal to the amount of each Qualifying Contribution. A Qualifying Contribution is a contribution of principal from Grantor to the Trust to the extent that, when added to all prior contributions from Grantor during the calendar year, the total does not exceed the lesser of (i) the amount of the annual exclusion under § 2503(b) of the Internal Revenue Code then available to Grantor with respect to Grantor's wife for such calendar year and (ii) the maximum amount that may lapse under §§ 2514(e) and 2041(b)(2) without constituting the release of a general power of appointment. Promptly upon receipt of a Qualifying Contribution, the trustee shall notify Spouse of her right to withdraw under this section. The right to withdraw shall terminate upon the expiration of 30 days after the receipt of such notice. Spouse shall exercise this right of withdrawal by written advice delivered to a trustee.

Under Article VI of Trust, the trustees have broad powers to invest, dispose of and otherwise deal with property in Trust, whether originally contributed to Trust, acquired by Trust or previously substituted into the Trust by Grantor, without the approval or consent of any other person.

Section 7.7 of Trust provides that Grantor may acquire any or all property constituting trust principal by substitution of other property of equivalent value to the property acquired measured at the time of substitution. The trust provides that, for purposes of section 7.7, property with equal value for federal gift tax purposes be deemed to be property of equivalent value. Grantor's power to acquire trust property may only be exercised in a fiduciary capacity. Action in a fiduciary capacity means

action that is undertaken in good faith and in the best interests of the Trust and its beneficiaries subject to fiduciary standards imposed under applicable state law.

Grantor proposes to exercise his power of substitution by transferring shares of Company 1 stock that he currently holds in exchange for shares of Company 2 stock that the Trust currently holds. In addition, if necessary, Grantor will transfer to or withdraw from Trust cash or cash equivalents in an amount necessary to make the total value of the assets transferred to the Trust equal to the total value of the assets withdrawn from the Trust as a result of the substitution.

It is represented that Trustees 1 and 2 are not descendants of Grantor and are not otherwise related or subordinate to him within the meaning of § 672(c). Further, under Article VIII any vacancy in the office of trustee must be filled by a person who is not related or subordinate to Grantor as defined in § 672(c). It is represented that Company 1 is publicly traded on Exchange 1 and Company 2 is publicly traded on Exchange 2. It is further represented that whenever shares of Company 1, Company 2, or any other publicly traded stock are transferred into or out of Trust, each share will be valued at the mean between the highest and lowest quoted selling price on the exchange on which the share is principally sold on the date of the transfer in accordance with § 25.2512-2(b)(1) of the Gift Tax Regulations. Finally, it is represented that the independent trustee has a duty to ensure that the value of the assets being acquired is equivalent to the value of the assets that are substituted by Grantor.

You have requested the following rulings:

1. The retention by Grantor of the power of substitution will not cause Trust property to be included in Grantor's gross estate for federal estate tax purposes under §§ 2033, 2036(a), 2038, or 2039.
2. The exercise by Grantor of the power of substitution will not constitute a gift to Trust for gift tax purposes if the total value of assets transferred to Trust equals the total value of assets transferred from Trust.
3. For purposes of determining whether Grantor will be making a gift for gift tax purposes by exercising the power of substitution, the gift tax value of the Company 1 stock and the Company 2 stock will be determined by valuing each stock at the mean between its highest and lowest quoted selling price on Exchange 1 or Exchange 2, respectively, on the date of substitution, in accordance with § 25.2512-2(b)(1).
4. Trust is a grantor trust under § 671 in its entirety with respect to Grantor.
5. Neither Grantor nor Trust will recognize any income or loss by reason of the exercise of the power of substitution.

Ruling 1

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

Section 2039 provides that the value of the gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement if, under such contract or agreement, an annuity or other payment was payable to the decedent during life.

In Estate of Jordahl v. Commissioner, 65 T.C. 92 (1975), acq. 1977-1 C.B. 1, under the terms of an inter vivos trust created by the decedent, the decedent reserved the power to substitute other securities or property for those held by the trustee, provided that the property substituted was of equal value to the property replaced. The court held that the decedent's reserved power to substitute other securities or property of equal value was not a power to alter, amend or revoke the trust within the meaning of section 2038(a)(2). Rather, the court concluded that the requirement that the substituted property be equal in value to the assets replaced indicated that the substitution power was held in trust and, thus, was exercisable only in good faith and subject to fiduciary standards, such that the decedent was accountable in equity to the trust beneficiaries. Accordingly, the decedent could not exercise the power to deplete the trust or to shift trust benefits among the beneficiaries. See also, Rev. Rul. 2008-22,

2008-16 I.R.B. 796, considering the estate tax consequences of the retention of a nonfiduciary power to substitute assets of equivalent value.

In this case, under section 7.7 of Trust, Grantor has retained the power to acquire Trust property by substituting other property of equivalent value to the property acquired, measured at the time of substitution. Under the terms of Trust, the Grantor's power to acquire Trust property under this section may only be exercised in a fiduciary capacity. Accordingly, based on the facts presented and the representations made, we conclude that the retention by Grantor of the power of substitution will not cause Trust property to be included in Grantor's estate for estate tax purposes under §§ 2033, 2036(a), 2038, or 2039.

Ruling 2 and 3

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift and is included in computing the amount of gifts made during the calendar year. However, under § 25.2512-8, a transaction which is bona fide, at arm's length, and free from any donative intent will be considered as made for an adequate and full consideration in money or money's worth.

Under § 25.2512-1, the value of property, for gift tax purposes, is the price at which such property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts. Section 25.2512-2(b)(1) provides that, in general, if there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market or otherwise, the mean between the highest and lowest quoted selling prices on the date of the gift is the fair market value per share or bond.

In this case, under the terms of Trust, Grantor may substitute property of equivalent value for Trust property. Grantor proposes to transfer shares of Company 1 stock that he currently holds in exchange for shares of Company 2 stock that the Trust currently holds. In addition, if necessary, Grantor will transfer to or withdraw from Trust cash or cash equivalents in an amount necessary to make the total value of the assets transferred to the Trust equal to the total value of the assets withdrawn from the Trust

as a result of the substitution. It is represented that the value of the Company 1 stock and the Company 2 stock subject to the proposed exchange will be determined in accordance with § 25.2512-2(b)(1) as of the date of the exchange. In addition, to the extent necessary, Grantor either will transfer to Trust, or withdraw from Trust, cash or cash equivalents in an amount necessary such that the total value of the assets Grantor is transferring to Trust will equal the total value of the assets Grantor is acquiring from the Trust incident to the substitution. Based on the facts presented and the representations made, we conclude that the exercise by Grantor of the power of substitution will not constitute a gift to Trust for gift tax purposes if the total fair market value of assets transferred to Trust equals the total fair market value of assets transferred from Trust.

Rulings 4 and 5

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 677(a)(1) provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse.

Section 678(a) provides that a person other than the grantor is treated as the owner of any portion of a trust with respect to which: (1) the person has a power, exercisable solely by that person, to vest the corpus or the income therefrom in that person; or (2) the person has previously partially released or otherwise modified such a power and, after the release or modification, retains such control as would, within the principles of §§ 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof. Section 678(b) provides that § 678(a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is otherwise treated as the owner under the provisions of subpart E other than § 678.

Rev. Rul. 85-13, 1985-1 C.B. 184, concludes that if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. A grantor's receipt of the corpus of a trust in exchange for an unsecured promissory note was treated as an unsecured borrowing of the trust corpus which caused the grantor to be treated as the owner of the trust under § 675(3). The

transfer of the trust assets in exchange for the note was not recognized as a sale for federal income purposes.

Based solely on the facts and representations submitted, we conclude that the Trust will be a grantor trust all of which is treated as owned by Grantor under §§ 671 and 677(a), because all of the income and principal of Trust may be distributed to Spouse in the discretion of a nonadverse trustee. Therefore, Grantor's exercise of the power to substitute Trust assets will not result in the recognition of any gain or loss by Grantor or Trust for federal income tax purposes.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

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Copy of this letter